DEPARTMENT OF STATE

Washington, D.C. 20520

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November 10, 1980

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MEMORANDUM

TO: S/S - Mr. Peter Tarnoff

FROM: PA - William J. Dyess

SUBJECT: Issues for Transition Papers

PA believes its most useful contribution would be to provide background on the public-affairs implications of the issues that are selected, especially the current state of American public opinion regarding them.

We would prepare this material once the list had been settled upon.

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JAPANESE/US CIVIL AVIATION TALKS

Statement of the Issue

Informal civil aviation talks with Japan are scheduled for the week of January 12, 1981 in Honolulu. These talks will be held in an effort both to resolve current issues and to lay the groundwork for renegotiation of the bilateral agreement.

The US-Japan bilateral aviation agreement has been the source of friction between the two governments for more than two decades. This friction has increased in recent years. Prior to last fall, the most recent bilateral talks broke off in acrimony in March 1978 and the Japanese declined to meet for two and a half years.

The essence of Japanese dissatisfaction with the agreement is a feeling that it is "imbalanced" in two respects:

1) it permits services from U. S. cities to Japan by U. S. carriers but does not allow Japan Air Lines to serve those same cities;

2) it permits U. S. airlines to serve any city beyond Japan, e. g., Hong Kong from Tokyo, but limits severely the right of Japan Air Lines to serve cities beyond the United States. The agreement is less imbalanced than the Japanese feel it is, but their views are strongly held.

Among the other principal outstanding issues are:

-- Fifth freedom rights beyond Japan. U. S. carriers, particularly Northwest, carry a significant amount of traffic between Japan and other Asian countries. The Japanese feel that the U. S. airlines should not transport such a large volume of fifth freedom traffic, particularly since JAL does not have the ability to carry similar traffic between the U. S. and third countries.

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-- Gateways. U. S. airlines may fly to Japan from any U. S. city (eight cities are actually served) while JAL can serve only six U. S. points. On the other hand, Japan is allowed to fly from any city in Japan to six U. S. gateways while U. S. carriers can serve only three Japanese cities. JAL wants complete equality, i. e., dual tracking on all routes.

-- Predetermination of capacity on specific routes. The Japanese believe that excess capacity exists on certain routes between the U. S. and Japan. They prefer that any addition of capacity be approved by both parties. The recent designation of United Airlines has heightened their concern about this subject.

-- Charters. Japan alleges that its international airports face shortages of fuel and airport space and, therefore, it insists that only already designated scheduled carriers may operate charter flights to Narita Airport. It maintains, moreover, that the U. S., with three designated airlines, would further imbalance the relationship if its non-designated carriers offered charter programs. The U. S. non-designated airlines have thus been excluded from the market. In response, the USCAB has denied several charter applications made by JAL. Liberalization of charter rules is a prime objective for U. S. negotiators in future talks.

-- Pricing. The U. S. prefers to reduce to a minimum governmental involvement in setting prices and to provide airlines with flexibility to make pricing decisions based on market conditions. The Japanese strongly resist surrendering their authority in this area.

The Japanese contention that the agreement is imbalanced is in some measure true. The unlimited beyond rights are particularly valuable. There is substantial pressure in Japan to follow the U. K. example by abrogating the agreement and negotiating a new one. We would be unlikely to get an agreement with as favorable route and capacity terms. Recognizing the legitimacy of some of the Japanese claims is therefore of value. We also expect to gain from the negotiations explicit service rights for new American carriers; the agreement is currently ambiguous. We expect to gain pricing flexibility. Japan's rigid control of pricing under the agreement has prevented both low fares for discretionary travellers and fare increases to help U. S. airlines recover increased fuel costs. We also expect to gain rights for charter carriers to serve Japan. Presently, the Japanese allow charter flights only by carriers also flying scheduled service.

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Although we believe the U. S. aviation community will benefit from renegotiation of the bilateral, it is unlikely to please all U. S. carriers. It will undoubtedly be necessary, for example, to grant JAL traffic rights to Chicago, served now only by Northwest Orient and Flying Tigers. Success with the initiation of United service from Seattle will also drain Chicago traffic. We expect Northwest Orient and Flying Tigers to oppose an agreement which grants such additional services.

Time Constraints

We believe that the time for renegotiation of the agreement is propitious. The Japanese have told us that they wish to improve the aviation relationship and avoid yet another issue of bilateral friction. After years of deadlock, we are fresh from satisfactory resolution in September of a prickly service problem by Continental between Guam and Japan. The successful resolution of the Continental service problem created a momentum which should be maintained. Moreover, this agreement was achieved by deferring discussion of the broader bilateral issues, and the Japanese negotiators were criticized for satisfying U. S. concerns on a single issue without addressing the broader issues. To postpone the talks fuels this argument. Finally, the chief Japanese negotiator proved in September to be particularly objective and forthcoming. He is due to take a new job after January and will no longer be available.

If we do not proceed with the January talks, we will not be able to resolve the outstanding issues of Pan American service through Tokyo to China or United service from Seattle to Tokyo before the Japanese act on pending applications. The Japanese have said they are not prepared to approve either service. Failure to approve would, in our view, violate the bilateral. We do not believe these issues can be agreeably resolved except in the context of an overall review of the agreement. The bitterness likely to emerge from the failure to resolve these issues may well stall the revision talks for some time.

What We Are Doing

We are proceeding with preparations for the January talks. We expect during December to complete preparation of a coordinated U. S. Government position and to obtain the views of all interested segments of the U. S. aviation

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community. Because the talks are scheduled in the week before the change of administration, it is particularly important that the incoming administration understand the issues and be prepared to maintain the cohesion of the U. S. negotiating position.

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Wheat Trade Convention

The Issue

The 18-month effort of the International Wheat Council (IWC) to develop an acceptable outline of a new Wheat Trade Convention (WTC has paused to await the position of the new US administration. IWC Executive Secretary Parotte will consult with officials of USDA and the Department in mid-February in preparation for a special meeting of the IWC from March 3 to 6 during which a go/no-go decision on negotiating a new agreement is expected. If the US decides to continue to participate positively in developing the new convention, negotiations can begin prior to the expiration of the 1971 Wheat Trade Convention on June 30. If the US decides to oppose the approach, we will have to devise strategy and tactics for resisting and controlling the powerful demands of the rest of the world in various international fora for an international grains arrangement to improve market stability and enhance world food security.

Background

For many years the US has favored establishment of an internationally-coordinated system of nationally-held wheat stocks. A primary US objective has been to spread the burden of stockholding among the nations with a direct interest in the production and consumption of internationally-traded wheat. At present the US alone pursues a conscious national policy of acquiring and releasing large quantities of wheat (held in the farmer-owned reserve and CCC) in response to changing international market conditions. While this system has served the US and the world well -- so well that it is a strong disincentive to other nations to bear the cost of large reserves on a similar basis -- US reserves proved insufficient by themselves to accommodate the shock of 1973/74 and may again prove insufficient if world foodgrain crops are short in 1981.

The world food crisis of 1973/74 sparked a major search for a new international wheat stocking agreement. Formal negotiations were held under the UNCTAD umbrella in 1978/79. The agreement sought was a classic commodity agreement with negotiated buffer stock levels, automatic acquisition and release triggered by price movements in a narrow band and

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with special provisions and assistance for LDC participants to construct, stock and carry their portion of the world reserve system. These negotiations failed in February 1979 because participants failed to reach complete agreement on any of the three key elements: stock size, price bands and special provisions for LDCs. Hardly were negotiations suspended when changing market conditions made it apparent that the kind of agreement sought would have proved unworkable anyway. The achievable level of reserves would have been too small to guarantee world food security. The price bands would have been too rigid to bring about market stability. The trigger mechanisms would have been too automatic to respond to logistic and other variables.

Drawing lessons from the negotiations, the IWC began to seek an alternative approach for a new wheat agreement, building on areas of consensus developed during the negotiations. What has emerged is an outline for a system still based on the principle of coordinated reserve stocks but with acquisition and release governed by flexible criteria through a consultative mechanism. Members would pledge an amount of wheat stocks held in a manner consistent with their national policies and laws and made available to assist the international purposes of stabilization and security. At the start of the system the global amount might be small, only a few million tons. The US could probably meet its obligation through the operation of the farmer-owned reserve (without major new legislation or appropriations) and the EC could meet its commitment through the operation of its intervention stocks. Many nations, however, would have to create or set aside new national stocks.

The agreement would not attempt to hold prices within a fixed range. Rather, sharp and sudden percentage changes in international wheat prices would trigger a meeting of the IWC Executive Board to determine whether there were a need for an IWC consultative meeting to make recommendations to acquire/release stocks and take other measures to influence the supply and demand balance. The agreement would commit the IWC to help LDCs to set up reserves. As a practical matter, LDC reserves would provide self-insurance for participating developing countries and would not be released to world markets. The World Bank is now prepared to lend up to $2 billion to fund food storage and distribution improvements in LDCs, and it therefore seems possible that the IWC can be confined to a facilitative role without taking on direct responsibilities for development assistance. However, this and many other issues probably can only be clarified and settled in a negotiating context.

Attitudes within the IWC

There is unanimity of opinion with the IWC that the outline of the alternative approach is technically feasible, i.e. that it appears realistic and represents an improvement over the existing Convention which contains no concrete mechanism for dealing with international stress. At the same time, it would represent only a "starter" agreement, insufficient to guarantee either price stability or world food security. It is therefore unclear whether the new agreement would contain enough to satisfy the narrow interests of the groups concerned -- exporters, importers and developing countries - to be brought to a successful conclusion.

To the US, the new agreement would represent an acceptance for the first time by the international community that all nations have an obligation to bear part of the burden of holding the world's food security reserves. However, the system would initially be too small and untrustworthy to relieve the US of much of its current responsibility in this area. Representatives of US wheat producers who participated in some of the IWC meetings on the new approach concluded that it holds out neither great promise nor great threat to their immediate interests and gave us, in effect, a no-objection to continue with the process.

Among other exporters, the EC and Argentina are prepared to enter negotiations of the new agreement, in great part to accommodate to strong global pressures for some kind of an international grains agreement which improves upon existing mechanisms for dealing with stress conditions. Canada and Australia, on the other hand, are concerned about an agreement which would require them to make a commitment to hold reserves without promising them "commercial benefits", e.g., a minimum price guarantee. Alone in the IWC, Canada has a strong preference against negotiations. Importers, including the largest (Japan and the USSR), are generally ready to negotiate the new approach. A stock commitment from the USSR could be important because Soviet Union import fluctuations remain as in the early 1970's the largest single cause of the world grain market instability. However, even with a new agreement, changes in Soviet stock levels will remain as shrouded in secrecy as now.

International Pressures

The international consensus behind the desirability of an international wheat reserve system could not be stronger.

As the dependence of the developing countries on imported wheat has risen to the point where LDC imports now account for one-half of international wheat trade, their concerns about access to internationally traded wheat and about their national food security systems have mounted accordingly. The knowledge that world wheat stocks are again in 1980/81 falling to dangerously low levels has intensified their fear of a world food crisis. The clamor for a new international grains agreement has been recorded at all significant meetings of such bodies as the FAO and th World Food Council. A new international grains agreemer one of the few specific treaties sought by the develo countries in their proposed agenda for upcoming Global Nego ations.

Within the IWC the pressures to replace the 1971 Wheat Trade Convention are equally strong, with the EC currently maintaining that it will not agree to a further extension of the 1971 WTC and its companion agreement, the Food Aid Convention of 1980, unless active negotiations for a replacement convention are already underway by June 30. Up to now, other international organizations have accepted the proposition that the IWC is the appropriate body to lead the search for a new wheat agreement. If the process stalls in that organization, traditionally congenial to US interests, we would anticipate a scramble by the various other organizations to launch their own proposals. Thus, if the US decides not to push the process in the IWC positively, or if negotiations are held and founder, we will be under considerable pressue to develop and support some other scheme(s) for world food security reserves.

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The Future of the MTN Subsidies Code

The Issue: One of the major achievements of the Tokyo MTN round was a code to discipline the use of subsidies and deal with their effects on international trade. The Code obliges industrial-country signatories to abolish export subsidies, but recognizes that LDCs may have legitimate development needs for maintaining such subsidies. In the latter case, the Code calls on LDCs to "endeavor" to phase out subsidies. Alone among Code signatories, the US has interpreted the Code language to require LDCs to submit written "commitments" to phase out subsidies as a condition of US recognition of their accession. Pressure from Congress, industry, and labor has compelled the Administration to seek these commitments as quid pro quo for our granting an injury test in countervailing-duty investigations.

To date, the US policy has resulted in satisfactory commitments from Brazil, Uruguay, Pakistan and Korea. Negotiations with India broke down last summer when Congressional critics found a proposed Indian commitment inadequate. India is now challenging in the Code the US right to demand such commitments. They are also challenging the selective application of the injury test in the GATT. Other LDCs are closely watching this test of US policy. In addition, some developed countries -- Australia, New Zealand, Greece and Spain -- have been blocked from joining the Code by US insistence on explicit assurances to abolish subsidies.

The Indian challenge raises the issue of whether US interests are better served by continued pursuit of phase-out "commitments", or by relaxing this condition and instead encouraging wider accession to the Code. The former, our present course, might have been regarded as moderately successful if the Indian negotiations had not faltered. Unless a negotiated solution to that problem is reached before the GATT challenge runs its course early next year, we may face rising political costs in seeking commitments from other LDCs.

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Our aggressive "commitment" policy has also been weakened by criticism in the GATT of our DISC program, which is considered a proscribed subsidy under the Code. Our need to defend the DISC and to continue to block adoption of the 1976 GATT panel report that condemns it constrains our ability to use GATT dispute-settlement procedures generally, with respect to subsidies in particular.

Time Constraints: The Subsidies Code Committee will meet December 11 to discuss the U.S. decision not to recognize India's signature of the Subsidies Code because India did not submit a satisfactory commitment. The Indian GATT challenge on the selective application of the injury test will get underway in late January.

We are currently seeking to work out an arrangement with the French, Belgians, and Dutch which would dispose of GATT Panel reports critical of DISC and European tax practices. Even if this effort succeeds, however, we will remain vulnerable on DISC in the Subsidy Code Committee.

Where we are Going: In the face of the December and January deadlines we are attempting to avoid taking any positions which would foreclose options to the new Administration.

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U.S. INTERNATIONAL COMMODITY POLICY

U.S. Policy

The U.S. approach to international commodity agreements (ICAs) is based on our need for adequate supplies of raw materials at stable prices. In some key commodities, experience indicates that the stability we seek has not been obtained through the workings of the market. Rapid and unpredictable price changes discourage investment to meet future demand for these products, thus perpetuating the cycle.

The U.S. has thus examined individual commodity problems on a case-by-case basis. Where serious price fluctuations have existed--and where international measures can promote greater price and supply stability--we have worked actively with others to find international solutions. We strongly support reliance on buffer stocks as the most equitable and efficient means of dampening extreme price fluctuations around their long-term trend. We have also advocated full government financing of these stocks--to permit them to be large enough to avoid resort to export controls to defend floor prices, while providing consumers effective protection against price rises above their ceilings.

Commodity market instability also upsets balance of payments and planning efforts by LDC producers, giving them a common interest with consuming countries in developing workable stabilization arrangements. As a result, commodity policy has been a major focus of the North-South dialogue. In addition to price stabilization, the LDCs also seek improvement in export earnings stabilization and greater home processing and marketing of their raw materials. These were major themes of UNCTAD V (Manila) and preliminary debate over the Global Negotiations. The U.S. response in these areas has been (a) support of liberalized IMF facilities, as appropriate and (b) agreement in principle to our possible participation in non-price stabilizing arrangements to remedy structural weaknesses in certain markets. This type of "commodity development" agreement would focus on tasks such as improvement of market transparency, greater productivity, R&D and market promotion or expansion.

The U.S. currently belongs to ICAs in coffee, natural rubber, sugar and tin. We have also been a major participant in negotiations this year to reach new agreements on tin and cocoa--although being ultimately unable to agree to last month's outcome in cocoa. The U.S. also participated in

successful negotiations concluded last June, to establish the Common Fund for Commodities.

Current Issues (to be decided by June 1981)

Coffee. Members of the International Coffee Agreement recently negotiated the agreement's price range (at a level well below coffee prices of previous years) and implemented the export quota system as of October 1. As a condition to our concurrence in these actions, however, we insisted that the major Latin American producers commit themselves to eliminate PANCAFE, a producer cartel which manipulated futures markets to raise prices. This significant producer concession was taken in order to satisfy Congressional concerns, which had blocked passage of legislation empowering Customs to implement the provisions of the Agreement and thus fulfill our treaty commitments. The implementing legislation has been reported out of the House Ways and Means Committee, and we have made strenuous efforts to obtain Congressional approval before the end of the present session.

The Coffee Agreement expires in September 1982. Accordingly, consideration of a successor agreement is expected to begin by mid-1981.

If the implementing legislation is not passed in this session, the Reagan Administration will have to decide on the priority and tactics to be given to this legislation in the 97th Congress. It will also need to decide whether the U.S. will participate in renegotiations of the International Coffee Agreement and, if so, on what conditions.

Jute. An UNCTAD-sponsored negotiating conference will meet January 12-30 to attempt to agree on a non-price stabilizing commodity development arrangement for jute. The negotiation could serve as a model for future agreements in other commodities. Our major concern is that projects under such an agreement be generic in nature (of assistance to most or all producers with full information-sharing) rather than country-specific (which could duplicate existing economic aid programs).

If the January conference produces an agreement, the Reagan Administration will have to decide on the timing and priority of its submission as an executive agreement to the Congress. If no agreement is concluded, decisions will be required on what, if any, changes should be made in the U.S. position.

Tin. Negotiations on a sixth International Tin Agreement (ITA) are currently under way in Geneva (the fifth ITA expires on June 30, 1981). These negotiations could produce a new agreement this month or early in 1981. If agreement is not reached soon, there will be pressure to extend the present agreement for one

year. The U.S. has concentrated its efforts on substantial improvement of the major economic provisions of the agreement: i.e. an appropriate size and role for the buffer stock, full financing of the buffer stock, and substantial reduction in the use of export controls.

The Department (with concurrence of Treasury, Commerce, and USTR) has submitted to OMB a FY82 budget request of $165 million to cover estimated financial requirements of U.S. participation under a sixth ITA.

The Reagan Administration will thus have to decide (a) if negotiations for a sixth ITA have been successfully completed, whether the U.S. should join the agreement; (b) if so, on the timing and priority of seeking Congressional funding of our estimated contribution to the tin buffer stock; (c) if negotiations are still under way, whether and with what objectives the U.S. should continue to participate in them, and (d) whether the U.S. might agree to a one-year extension of the fifth ITA beyond June 30, 1981.

Common Fund. The Fund agreement of June 1980 envisages a First Account to facilitate financing of ICA buffer stock operations, backed by only a small amount of direct government contributions ($400 million) for limited collateral and short-term bridging purposes. The U.S. share of these contributions is $73.85 million in cash, promissary notes and on-call commitments all to be paid over a three-year period. The Fund's Second Account, funded by voluntary contributions, would assist certain commodity development measures. The U.S. has stated that it will not make a voluntary contribution to the Second Account for the foreseeable future.

Treasury is the lead agency for presentation of the agreement to the Congress and for management of possible U.S. participation once the Fund enters into force.

The U.S. signed the Fund agreement in early November. An appropriation request for the full U.S. contribution will be in the Administration's FY82 budget submission.

Consequently, the Reagan Administration will have to decide on (a) the timing and priority for submission to the Congress of legislation enabling the U.S. to participate in the Fund (either by executive agreement or by treaty); (b) U.S. funding of our contribution as a part of its general FY82 budget review.

Natural Rubber. The International Natural Rubber Agreement (INRA) entered into force provisionally in October 1980. Following Senate ratification, the U.S. has applied the INRA provisionally, pending Congressional consideration of the Administration's FY81 $88 million appropriations request to fund our estimated share of the INRA buffer stock under the

Treaty. The House approved that amount, but the Senate subcommittee reduced the appropriation to $45 million. The matter is unlikely to be resolved during the present session of Congress.

Consequently, the Reagan Administration will have to decide whether to renew the $88 million INF buffer stock appropriation request with the new Congress.

Future Issues

Cocoa. A new three-year International Cocoa Agreement (ICCA) was concluded last month in Geneva. The U.S. announced it would not join the new ICCA, however, because we do not consider it financially viable. Cocoa is thus unlikely to require major USG policy decisions before at least late 1982 when the ICCA next comes up for renewal.

Copper. Current discussions in UNCTAD on possible international measures are at an impasse. In 1979, the U.S. indicated willingness to consider price stabilization mechanisms for copper, but producers and consumers as a whole have failed to reach a consensus on any particular approach. If a new meeting on copper is scheduled during 1981, we will need to review our position.

Cotton. We have strongly resisted pressure from some producers for a price stabilization agreement. Instead we have supported creation of an IBRD/UNDP-sponsored Cotton Development International (CDI) which would undertake commodity development measures. The CDI would, among other things, allow the graceful expiration of the financially-troubled International Institute for Cotton (the IIC carries out market promotion and end-use research, mainly with USDA funding). Progress on CDI has been disappointing, however. An eventual decision may thus be required on what new international steps might be desirable for cotton.

Sugar. The current International Sugar Agreement (ISA) expires at the end of 1982. Serious preparatory work for a renegotiation will begin in late 1981 and formal negotiations should begin by early 1982. Major issues will be the size and financing of national stocks, the price range, and possible accession by the European Community (the EC is not in the current ISA). The U.S. approach to these negotiations will also be affected, of course, by domestic price support decisions on sugar next year.

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US GRAIN TRADE WITH THE USSR

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Issue

The US is the largest exporter of grain to the world market. Over the last decade the Soviet Union has become the world's largest grain importer with the US supplying the bulk of its needs. Since 1975 our grain trade with the USSR has been regulated by a bilateral supply agreement which has decreased the year-to-year fluctuations in Soviet purchases of US grain and the consequent disruptions in the US market. Since January 1980 the partial embargo has limited US sales to the USSR to 8 million metric tons (MMT). Decisions on the partial embargo and the bilateral agreement, which expires in September 1981, are key to the future of our grain trade with the USSR.

Background

In response to the Soviet invasion of Afghanistan, on January 4, 1980 President Carter announced an embargo on exports of US agricultural products to the USSR. In order to honor the US commitment under the US/USSR Grains Agreement the President allowed annual sales of 8 million metric tons (MMT) of wheat and corn, while withholding 17 million tons which the Soviets had contracted for. He imposed a total embargo on sales of soybeans and soybean products (affecting approximately 1.4 million tons), meat products and other items not covered by the grain agreement which have a potential impact on the Soviet feed and livestock sector.

Exporter Cooperation

At a January meeting in Washington of major grain exporters, Canada, Australia, and the EC (but not Argentina) agreed to support the embargo by not replacing grain withheld by the US. (Subsequently Argentina did give us confidential assurances that feedgrain and soybean exports to the USSR would not exceed 4.5 MMT in 1979/80 but actual exports were 20% above this level.) The EC, which has not issued any new licenses for grain sales to the USSR since January, has been the most cooperative of the exporters. Australia went along with the US by limiting its grain sales to the USSR to 3.9 MMT despite strong

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producer opposition. The previous government of Canadian Prime Minister Joe Clark agreed to restrain Canadian grain exports in 1979/80 but Presidential intervention was necessary to persuade Trudeau, who succeeded Clark, to defer new sales to the USSR in May. After a second meeting of the major grain exporters in Brussels in late May the others agreed to continue their general cooperation on the partial embargo in the 1980/81 crop year. However, Canada declined to limit its 1980/81 grains exports to the USSR to a specific volume.

At the most recent exporters meeting in Adelaide November 10-14 the US expressed the hope that the others would not change their policies until the new Administration had time to review the issue. The EC Commission reiterated its support for the partial embargo and announced its intention to continue to restrain exports of EC grains to the USSR. Shortly thereafter the Australian Government announced that it would maintain restraints as long as the other countries did so. On November 28, however, Canada announced a decision to resume normal sales to the USSR, as well as a new contract with the USSR which would bring grain exports to the Soviets to a record level of 5.5-6.0 MMT in 1980/81.

Maintaining exporter cooperation has proved extremely difficult. Cooperating governments have come under heavy fire from their own producers. The doubling of normal levels of Argentine grain exports to the USSR in 1979/80, capped by conclusion of a 5-year grain supply agreement with the Soviets in July, created a major gap in the embargo. The other exporters, noting record global exports of US grains, have charged that we have taken advantage of the partial embargo to raid their traditional markets. The announcement in October of the new US/China Grains Agreement exacerbated the disaffection of Canada and Australia with the embargo policy. Other sore points have been the persistent allegations of diversion to the USSR of grains and soybean meal through Western and Eastern Europe. Now that Canada is no longer limiting its exports to the USSR, Australia appears to be wavering. The EC is under strong pressure from the French to lift its restraints.

At the outset of the embargo the US attempted unsuccessfully to obtain cooperation from other major exporters to restrict Soviet imports of soybean and soybean products (Argentine, Brazil) and of meat (Australia, New Zealand, EC, Argentine).

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Impact on USSR

The Soviets experienced a disastrous grain harvest of only 179 MMT in 1979, which caused them to seek imports of 36 MMT. With the cooperation of the other grains exporters, intended Soviet imports in the October 1979-September 1980 period were reduced by 8-9 MMT to 27-28 MMT. Meat imports soared to a record level of over 600,000 tons. In the wake of the second successive poor harvest in 1980 (185 MMT) the impact of the partial grain embargo on the politically sensitive Soviet livestock sector is becoming more pronounced. We estimate that the Soviets drew down their grain stocks by about 20 MMT last year, making further draw downs this year unlikely. The Soviets will either have to cut meat production now to maintain livestock herd strength or begin distress slaughtering, which would result in a temporary bulge in meat production followed by a sharp decline next year. Even the anticipated record meat imports again this year will not compensate for decreased production. Soviet meat production in 1980 will be off by about 5% and per capita meat consumption could drop by as much as 10% in 1981. Given the tight Soviet supply situation as well as the limited Soviet port capacity the Soviets will have difficulty obtaining adequate grain at least until the fall of 1981, with or without an embargo.

The USSR has succeeded in meeting most of its needs for soybeans and soybean meal. Imports of soybeans have come from Argentina (0.7 MMT) and Brazil (0.1 MMT). Western Europe (primarily the Netherlands and the FRG) supplied an estimated 350-370,000 MT of meal. Unlike the case of grains on which the EC Commission can effectively impose destination controls by withholding the subsidies needed to make its prices competitive, the EC does not have a mechanism for controlling meal exports. US and South American beans enter the EC duty free, are crushed locally and exported without subsidy.

Bilateral Agreement

The US/USSR Long-Term Agreement on Grain Trade was negotiated in 1975 to avert "great grain robberies" like those of the early seventies. It allows the US Government to forestall large unexpected Soviet grain purchases without instituting export controls. It

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also guarantees minimum annual sales levels. Under the agreement the USSR is committed to buy at least 6 MMT of US wheat and corn annually, while the US is committed to allow sales of 8 MMT without consultations. The export of 8 MMT of grains (5 MMT of corn and 3 MMT of wheat) has thus been permitted during both the 1979/80 and 1980/81 agreement years. The Soviets have already purchased the entire amount for 1980/81 but are not permitted to ship more than half the total in any quarter.

In view of the massive import needs of the Soviets and their capacity to disrupt our domestic markets, we cannot return to a situation like that of the early seventies in which the Soviets have unrestricted access to US grain. The question is whether we control this trade bilaterally through an agreement with the USSR or through unilateral US actions.

If the US decides to negotiate a renewal of the grains agreement, the Soviets would press very hard for language exempting them from a future embargo and would probably also seek a higher floor for purchases without consultations with the US (at least 9 MMT to match the level specified in the US/China Agreement). However, given the extent of their needs the Soviets might ultimately drop their insistence on these points. An alternative to renegotiation would be to inform the Soviets that we would agree to extend the agreement for one year as provided under Article IX. It is not certain that the USSR would accept this approach.

If it is decided to allow the agreement to lapse, the USG could regulate grain trade with the USSR by maintaining controls and the requirements for export licenses and reports on export transactions from the grain companies. The USG could decide from year-to-year whether the level of grain sales to the Soviets should be restrictive or not. Because the supply of feedgrains is tight this year there will be an argument for maintaining controls on exports to the USSR to hold down domestic grain and meat prices.

Time Constraints

Although there is no specific deadline for a decision on the future of the partial grains embargo, the Canadian decision to resume normal exports and

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Australia's wavering argue for a prompt decision. There will be pressure for action from the Congress and the farm sector. While we have made no promises, the cooperating exporters clearly expect to be consulted before the US decision is announced.

A decision on whether to renew the US/USSR Grain Agreement, extend it or allow it to lapse will be needed well in advance of the September 30, 1981 expiration date, in order to permit adequate time for negotiations if the agreement is to be renewed. We have stated publicly that no decision has yet been made on the future of the US/USSR Grain Agreement. There has been no initiative from the Soviet side.

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INTERNATIONAL ECONOMIC POLICY

The View from the State Department

International economic policy issues -- trade, energy, investment, stabilization -- have an important bearing on domestic output, employment and inflation. No wonder, then, that in considering these issues the domestic agencies focus on the effects of these issues on particular constituencies or interests they represent -- labor, business, agriculture, Congress, revenues, antitrust law. In contrast, the State Department's basic constituency is the President, whose own global strategy and priorities shape the Department's view of international economic policy issues. Since the Department's mandate is to serve the President, and to advance a general view of the national interest, it has traditionally been as strong or as ineffectual, as the President wants it to be.

Nonetheless, any Secretary of State will have an interest in international economic issues since by definition such issues involve our foreign relations. That is, the Department must see to it that economic policies are consistent with our foreign policy as well as with basic national objectives: security, strengthening democratic institutions, and expanding the open international market system in which the US has a growing stake. A protectionist trade war among the Western Allies, or vicious competition for oil supplies would create tensions in the Alliance and could weaken it. Moreover, sound management of the world economy is essential to achievement of prosperity and social goals at home.

Although diminished in relative power since World War II, US military, economic, and political strength remain decisive elements affecting the course of global events. As a result of this pervasive influence and exposure, US foreign policy must be conducted, not as a collection of independent initiatives, but as a coherent whole. The State Department is in a unique position to help the President oversee this process.

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Policy Formulation - interagency consensus building

As implied above, the State Department's influence, or lack thereof, in the economic policy process derives both from its stature and from its legislative mandate. Over the years, moreover, the Department's legislative mandate to exercise the lead responsibility in forging interagency consensus on economic issues has been reduced. Today, the Department retains primary responsibility for the North/South dialogue, bilateral civil aviation agreements, fisheries, ocean and polar affairs, and telecommunications. On issues of trade, energy, commodities, investment, development finance and monetary policy, the Department is a major participant, usually second in importance to the lead agency -- USTR, Treasury, Agriculture, DOE.

A problem for the Department has been that some agencies, in exercising their lead responsibility, have not always addressed issues in a collective, interagency fashion. In taking independent decisions, they have at times failed to give adequate weight to Department views of the foreign policy consequences.

Aside from the interagency groups formed to deal with discrete issues, this Administration instituted a weekly lunch to serve as a principal forum for coordination of broad international economic policy among the Under Secretary (E), the EB Assistant Secretary, Treasury's Under Secretary for Monetary Affairs, the Deputy Trade Representative and the senior economic staff member on the NSC.

Implementation

Of the three principal operational functions abroad -- negotiation, representation, and reporting/analysis -- the Department and Foreign Service exercise principal responsibility for the last two, and frequently for negotiation as well. Treasury and Agriculture reporting specialists serve at key posts, and the Commerce Department recently took over Commercial functions at 65 posts, but the Foreign Service has retained responsibility for representation of US economic interests before host government authorities abroad. In some international organizations, other agencies occasionally staff US representation, such as GATT (USTR), IBRD (Treasury), FAO (Agriculture), but Foreign Service Officers predominate in others - e.g. UNCTAD, OECD, and

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the US Mission to the EEC. The overseas reporting and analysis functions on which policy formulation heavily depends, is a major Foreign Service responsibility.

Although negotiation has traditionally been regarded as a State Department/Foreign Service function, on economic issues the Department is as often a participant on US delegations as chief negotiator. The 1979 Trade Reorganization shifted negotiating authority on commodity and certain investment issues from the Department to USTR.

Bureau Relations

1) E and EB - The relationship between EB and E is inevitably a close one but it has varied widely through the years in good measure as a function both of personality and the substantive interests of the Under Secretary.

As one of the most senior economic officials in the government, the Under Secretary is in a position to influence the broad range of economic policies by bringing to bear the Department's unique capacity for weighing strategic and political, as well as economic, implications of major issues. Since the Secretary does not have time to deal closely with all important economic issues, the Under Secretary is an essential principal, serving as the Department's spokesman when representation at or near the cabinet level is required to make policy or to testify before Congress. Internally, the presence of the Under Secretary is needed to ensure that major economic issues are raised to the Secretary's attention. Without the Under Secretary serving as a conduit, EB Bureau would be left at a disadvantage in competing for the Secretary's ear with sixteen other Assistant Secretaries.

But the Under Secretary himself has neither the staff nor the time to deal with all of the major and minor economic issues that affect our foreign relations. For analytical and bureaucratic support, he must rely principally on EB Bureau and its staff of over 200 professionals. The EB Assistant Secretary also wields considerable policy influence, especially when he has strong backing from the Under Secretary and, when necessary, from the Secretary himself.

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In any case, EB exercises substantial influence over economic policies through excellent staff work and aggressive leadership.

2) EB and the Regional and Functional Bureaus - The relationships here are characterized by constructive tension usually concluding in reconciled views. Within the Department, EB's responsibility is to ensure that other bureaus appreciate the importance of maintaining globally coherent economic policies, rather than a collection of ad hoc policies responding to specific bilateral interests. Inter-bureau tensions arise when EB perceives that a regional bureau or a single-issue bureau (e.g. Narcotics, HA) is pursuing policies that do not adequately safeguard economic interests. The reverse situation also occurs, of course. On important issues with substantial political and economic content, achieving a consensus position among competing bureaus within the Department can be as difficult as reaching an interagency consensus. However, one function of the Secretary and other 7th floor principals is to decide on a Departmental position.

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